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December 1, 1997

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY HAND DELIVERY

Magalie Salas, Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128

Dear Ms. Salas:

Please find enclosed for filing an original and 11 copies of the RBOC/GTE/SNET Coalition's Petition for Reconsideration of the Second Report and Order in the above-captioned proceeding.

Please date-stamp and return the extra copy provided to the individual delivering this package.

Sincerely,

Michael Kellogg

Michael K. Kellogg

Enclosures

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DEC 1 - 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the	)	
Telecommunications Act of 1996	)	

PETITION FOR RECONSIDERATION

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December 1, 1997

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EXECUTIVE SUMMARY

The Commission has correctly concluded that a "market-based rate" for per-call compensation for access code and subscriber 800 calls "promotes the goals of Section 276 of the Act, fair compensation, the deployment of payphones, and competition." Second Report and Order, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, ¶ 117 ("Second Report and Order"). The Commission's methodology is, for the most part, sound. Its application, however, is flawed in critical respects. This petition for reconsideration points out the errors of application one by one, and calls for their correction. It is in the interest of all parties and the Commission to ensure that the per-call compensation rate is adequate to "ensure . . . fair[] compensat[ion]" and "to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1).

I. The Commission's avoided cost pricing methodology, which adjusts the market-determined local coin rate for differences in costs between local coin calling on the one hand and subscriber 800 and access code calling on the other, is an appropriate way to ensure that the per-call compensation rate set by the Commission mirrors the results that would be reached in a free and competitive market. It was nonetheless wrong for the Commission to refuse to take demand conditions into account. Where two products have a large proportion of joint and common costs and the elasticities of demand for those products differ, a competitive firm will recover a higher proportion of those joint and common costs from the consumers of the product for which demand is less elastic. With this point, evidently, the Commission agreed.

But the Commission altogether declined to take into account differences in demand conditions for local coin calls and dial around/subscriber 800 calls, evidently believing that it had insufficient information on relative demand conditions. This was error: the elasticity calculations made available to the Commission were conservative but highly reliable estimates of relative demand conditions. More important, even if the Commission were to assume that demand for dial-around and subscriber 800 calls is much more elastic than those calculations indicated, it is still clear that the per-call compensation rate would be set at least as high as the local coin rate. By ignoring the lesson that demand analysis teaches, the Commission threatens to undermine the statutory goals it sets out to serve.

II. Leaving considerations of demand conditions to one side, the Commission's avoided cost methodology is generally sound, and far superior to the regulatory cost-based approach that the Commission properly rejected. The Commission, however, made several significant errors in its application of this methodology. When those errors are corrected, the proper adjustment to the local coin rate is not -$.066, but +$.012. Hence, the default per-call rate should be changed to $.362.

A. The Commission's treatment of coin mechanism costs is flawed for three reasons.

1. Coin mechanism capital costs are simply not avoided costs. They are not incremental costs of coin calling that are literally avoided when a consumer makes a coinless call. Nor are they avoidable costs that a competitive firm would avoid in the long run. This is because, as the Commission's own numbers show, most payphones would not exist but for the coin mechanism; per-call costs for a coinless phone are — in nearly every case — far higher than per-call costs for coin phones. The coin mechanism is not a cost but a benefit to coinless callers.

The market confirms this: the only place where coinless phones predominate is in inmate facilities, where coins are not available. Adjusting the per-call compensation rate for coin mechanism costs is therefore flatly mistaken.

2. Even if coin mechanism costs were avoidable, the Commission has overstated them. Any realistic account of payphone costs suggests that the $710 figure supplied by AT&T is severely inflated.

3. The Commission erred by allocating coin mechanism calls across the number of coin calls made on a marginal payphone. Because such costs are fixed, rather than incremental, they should have been allocated across average call volumes. Otherwise, PSPs will — on average — provide a discount to IXCs that exceeds the coin mechanism costs that are supposedly unnecessary to coinless calls. This amounts to a simple transfer of wealth to the IXCs, and cannot be justified.

B. The Commission also overstated the amount that PSPs save on line charges when their payphones are used to make long distance calls rather than local calls. The Commission double-counted certain data and ignored other data; nowhere does the Commission explain this arbitrary treatment.

C. The Commission should not have ignored bad debt and collection costs. Both common sense and data submitted by the parties indicate that such costs are significant; there was no reason to reject the $.04 figure offered by independent PSPs. In all events, to set this amount at zero was totally unjustified.

D. The Commission's treatment of ANI ii costs was flatly incorrect. There is no question that ANI ii costs should be allocated to access code and subscriber 800 calls only, not to all calls as the Commission has done. The Commission's own treatment of coin mechanism costs is plainly inconsistent with its treatment of ANI ii costs. Even when ANI ii costs are adjusted to reflect lower cost estimates recently submitted to the Commission, the per-call amount of these costs, when properly allocated, increases the amount of per-call compensation.

III. To the extent the Commission was reassured by the closeness of its cost calculations and its avoided cost figure, its confidence was misplaced. First, its cost methodology is biased downwards and underestimates the per-call costs of low-volume, high-cost providers. Second, many of the errors that affected its avoided cost calculation also reduced the Commission's cost-based calculation. Finally, the Commission cannot justify its decision to ignore location rents completely — these costs are real, they must be incurred, and they are properly chargeable in part to the IXCs who benefit from payphone placement. The errors and uncertainties that plague this cost-based calculation simply underline the wisdom of the Commission's decision to set a market-based per-call compensation rate.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

Implementation of the Pay Telephone	)
Reclassification and Compensation	) CC Docket No. 96-128
Provisions of the	)
Telecommunications Act of 1996	)

PETITION FOR RECONSIDERATION

The RBOC/GTE/SNET Payphone Coalition hereby seeks reconsideration of the Commission's Second Report and Order in this rulemaking proceeding. The Coalition supports the Commission's decision to adopt an avoided cost approach to calculating per-call compensation, based on the unregulated local coin rate. But the Commission's application of this avoided cost methodology contains errors and contradictions that should be corrected on reconsideration.

In this petition, the Coalition covers point by point the errors in the Commission's Order. The petition addresses overall methodology first, then discusses specific errors in the Commission's avoided cost calculations in the same sequence they occur in the Order. The petition also demonstrates that the Commission's bottom-up cost calculations, upon which the Commission wisely chose not to rely, were also flawed.

I. THE COMMISSION'S AVOIDED COST APPROACH IS FUNDAMENTALLY SOUND, BUT SHOULD ADJUST FOR CONDITIONS OF DEMAND

A. Avoided Cost Methodology Is Superior to Cost-Based Approaches

From the beginning of this rulemaking, the Commission has recognized that any price set by a free and open market is, by definition, the "fair" rate. See Notice of Proposed Rulemaking, 11 FCC Rcd 6716, 6725, ¶ 16 (1996). And because the market yields not merely a fair price, but an efficient price, this best serves the public interest as well. The Coalition has consistently supported the Commission's effort to arrive at a market-based compensation rate and applauds its decision to reject the IXCs' continuing efforts to have per-call compensation rates based on regulatory cost accounting measures. As the Coalition has pointed out from the beginning, cost-based pricing is inefficient, administratively cumbersome, and a threat to the widespread deployment of payphones.

The Commission chose to set a market-based rate for access code and subscriber 800 calls by starting with the local coin rate — a price set in a free and competitive market with low barriers to entry — and adjusting that rate for cost differences between local coin calls and coinless calls. This avoided cost methodology is one way of heeding the lessons taught by the market, and it is not without its strengths. By adjusting for costs avoided — and incurred — when a payphone is used for dial-around and subscriber 800 calls, this approach ensures that the payphone provider is indifferent to whether the consumer makes a subscriber 800 call, a dial-around long distance call, or a coin call: in each case there is the same "profit," and the same contribution to joint and common costs. Indeed, if the relative elasticities of demand for all call types were similar (an assumption contrary to fact), avoided cost pricing would mirror the market and set an efficient per-call compensation rate. See Declaration of Professor Jerry A. Hausman ¶ 12 n.8 ("Hausman Decl.") (attached hereto as Exhibit B). And last but certainly not least, the avoided cost calculation responds directly to the D.C. Circuit's sole criticism of the Commission's decision to set per-call compensation equal to the local coin rate: that the Commission failed to account for record evidence of differences in costs between coin and coinless calls. See Illinois Pub. Telecomm. Ass'n v. FCC, 117 F.3d 555, 564 (D.C. Cir. 1997).

Given the choice between avoided-cost pricing and an approach based on average costs or incremental costs, only avoided-cost pricing will ensure that marginal payphones — those with higher than average costs or lower than average call volumes or both — are not put out of business. Avoided cost pricing starts with a competitive, market-determined price — the local coin rate — as its baseline. This ensures that differences in call volumes and payphone costs in different regions are taken into account; cost-based pricing ignores such differences by relying on average call volumes or average costs or both. Market-based rates adjust automatically as technology and economic conditions change; a cost-based rate would require constant and costly administrative revision. See Hausman Decl. ¶ 9. Leaving considerations of demand conditions to one side, avoided cost pricing serves the intent of Congress — an efficient supply of payphones, a competitive market, and widespread payphone deployment — far better than any cost-based approach.

B. The Commission Erred by Refusing to Take Demand Conditions Into Account

Avoided cost pricing does a far better job than cost-based pricing of mirroring market results; however, taking demand conditions into account would be better still. All calls are not alike: a payphone offers consumers several products, including local coin calls and access code/ subscriber 800 calls. As the Commission has recognized from the start, these products share significant joint and common costs. See, e.g., Report and Order, 11 FCC Rcd 20541, 20576, ¶ 68 (1996). In this situation, a competitive firm will price such products in inverse proportion to the relative elasticity of demand. As the Coalition explained in its comments following remand, the firm will recover a larger portion of joint and common costs on the sale of products for which there is a lower elasticity of demand, and a smaller portion from those with higher elasticities. See Coalition Comments, at 20-24 (filed Aug. 26, 1997). This is not an obscure point of economic theory, but common sense verified by everyday experience. Anyone who has been obliged to purchase an airline ticket for weekday travel at the last minute has learned this lesson.

The Coalition, citing an analysis by economist Dr. Jerry A. Hausman, has presented evidence that the percentage fall in demand for local coin calling as a result of a percentage increase in the price of a local call is greater than the percentage fall in demand for dial-around and subscriber 800 calls as a result of a percentage increase in the per-call compensation rate: in other words, elasticity of demand for local coin calls is higher. See id. & Declaration of Professor Jerry A. Hausman ¶¶ 19-29, dated Aug. 25, 1997, attached to Coalition Comments. A competitive firm would therefore allocate more of its joint and common costs to the per-call compensation charge than to the local coin rate; per-call compensation should therefore be higher than the local coin rate — by at least $.07. Id. at 16.

1. The Coalition's Elasticity and Price Data Were Reliable

The Commission acknowledges that a competitive firm would take account of differences in demand elasticities — indeed the Commission never takes issue with the Coalition's analytical approach at all — but declines to take relative elasticities into account in setting its per-call compensation rate because of a lack of confidence in the elasticity numbers in the record. See Second Report and Order ¶¶ 64, 67. That lack of confidence is unwarranted; moreover, and in any event, it does not justify the Commission's refusal to make any allowances for differences in demand. Given even an unrealistically conservative estimate for elasticity of demand for long-distance calls, a competitive firm would still set the per-call compensation rate for dial-around and subscriber 800 calls higher, not lower, than the deregulated local coin rate. The Commission's failure to take demand conditions into account is arbitrary.

Dr. Hausman's elasticity data were derived from two sources. His estimate of the elasticity of demand for long distance and subscriber 800 services was based on his own and others' scholarly research; his calculation of elasticity of demand for local coin calling was empirical, based on data provided by a Coalition member. A few parties tried to throw darts at Dr. Hausman's elasticity calculations, but none came close to its mark.

For example, AT&T submitted comments criticizing Dr. Hausman's decision to rely on the overall price elasticity for long-distance calls, rather than the elasticity of dial-around payphone long-distance calls only. What AT&T's comments do not recognize was that this decision was conservative: as the FCC's own reasoning points out, those who make long-distance calls from payphones, and who thereby accept the higher costs that such calls entail, are surely less price-sensitive than the universe of consumers as a whole — they "have already made choices [despite] . . . price differences." Second Report and Order ¶ 66. The overall elasticity of demand for long-distance calling is therefore surely higher than the elasticity of demand for access code calls. See Hausman Decl. ¶ 4. This means that the derived demand elasticities are similarly conservative; the Coalition's comments therefore reflected a price lower than the rate that would be set in the market.[1] There is therefore no reason to believe that Dr. Hausman's relative elasticity estimates are anything but conservative.

Moreover — and this is a point the Commission ignores — Dr. Hausman's analytical approach is empirically verified. PSPs already receive commissions for 0+ calls — which have similar demand characteristics to dial-around calls and which are set in a highly competitive market — well in excess of the local coin rate. See Coalition Comments at 9-11.

Finally, the Commission also takes issue with the price data used by Dr. Hausman. But his choice of historical AT&T data was not only reasonable, no one has suggested that a different number would be more appropriate. And even if the price of the average dial-around call were arbitrarily adjusted downward 20 percent, Dr. Hausman's analysis nonetheless indicates that a competitive firm would set per-call compensation well above the local coin rate. Hausman Decl. ¶ 7 n.3.

2. *The Commission Fails to Recognize That Under any Plausible Account of Demand Conditions, the Per-Call Default Rate Should Exceed the Local Coin Rate*

Even if the Commission were justified in questioning the accuracy of the numbers Dr. Hausman used, the Commission simply fails to consider just how different the estimated elasticities would have to be to produce a per-call rate below the local coin rate, let alone almost $.07 below. In his declaration accompanying this petition, Dr. Hausman shows that the price

[1]MCI's claim that the elasticity for local coin calls is lower than Dr. Hausman estimates is similarly specious: the demand figure upon which MCI relied was biased low and based upon incorrect econometric techniques. See Hausman Decl. ¶ 5 n.2.

elasticity for dial-around long distance would have to be a number so high that it would imply that the price for long-distance calling was being set by an unregulated monopolist — an incredible proposition — merely to support per-call compensation equal to the local coin rate. See Hausman Decl. ¶ 7.

The Commission's statement that it is impossible to make any judgment about the relative demand elasticities for local calling and access code and subscriber 800 service — see Second Report and Order ¶ 67 — blinks the facts. There is no defensible way to accept the proposition that competitive firms take demand elasticities into account, as the Commission does, and to reject the proposition that the per-call compensation rate should be significantly higher than the local coin rate.

This analysis raises a red flag. It is crucial to keep in mind that the per-call compensation rate is a default rate. As the Commission has found — a finding endorsed by the D.C. Circuit — IXCs have the capacity to block calls made on specific payphones. See Order on Reconsideration, 11 FCC Rcd 21233, 21268-69, ¶ 71 (1996); Illinois Pub. Telecomm. Ass'n, 117 F.2d at 564. Though they do their best to make the Commission forget it,[2] IXCs are free to offer whatever compensation they choose for access to PSP facilities. If an IXC believes that PSPs charge too much for access, it can block calls from those payphones. It thus has bargaining power in negotiating with PSPs for a lower per-call compensation rate. TOCSIA deprives PSPs

[2] See for example the study submitted by MCI purporting to show that per-call compensation that is "set" too high will harm consumers. See MCI Ex Parte, October 6, 1997. Never does the study consider the possibility that IXCs could negotiate for a lower rate.

of any such bargaining power.[3] The whole point of a default rate is to set it high enough to return to PSPs some of the bargaining power that TOCSIA took away in their negotiations with IXCs.

Congress was clear: payphone deregulation should be implemented in a way that will "promote competition among payphone service providers and promote the widespread deployment of payphone services." 47 U.S.C. § 276(b)(1). If the per-call default rate is set too low, neither of these ends will be served.

II. THE COMMISSION'S AVOIDED COST CALCULATIONS OVERSTATE AVOIDED COSTS AND UNDERSTATE ADDITIONAL COSTS ASSOCIATED WITH DIAL-AROUND AND SUBSCRIBER 800 CALLS

A. Coin Mechanism Costs Were Grossly Overstated

1. Coin Mechanism Costs Are Not Avoided or Avoidable Costs

The Commission notes arguments that coin mechanism costs should not be considered avoidable costs because "few locations could support a coinless instrument." Second Report and Order ¶ 43. But apparently the Commission missed the significance of those arguments.

A proper "avoided cost" analysis adjusts for two different types of costs. First, certain marginal costs may be literally avoided when a payphone is used for an access code call rather than a local coin call — for example, the PSP will not incur any costs associated with coin collection when a customer uses the payphone simply to make a coinless, access code call through an IXC. Narrowly speaking, these costs are avoided costs. Secondly, there are costs that

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[3]The Commission has persistently and wrongly argued that an IXC and a PSP might negotiate a higher than default compensation rate if the phone would not be viable at the default rate and long distance calling is still profitable for the IXC at the higher rate. But no IXC would be willing to subsidize its competitors by paying additional compensation to support a payphone that could be used to make long distance calls using any provider. This is the classic "tragedy of the commons" problem. See Hausman Decl. ¶ 8 & n.6.

could be avoided if the PSP were willing to provide a telephone that lacked certain functionality — for example, if PSPs were permitted to block dial-around calls, they would have no need to pay for ANI ii. Avoidable costs are costs that are not, properly speaking, common to all functions of the payphone, and therefore avoidable in the long run.

The Commission's single largest adjustment to the local coin rate was a reduction of \$.031 to reflect the capital costs of the coin mechanism. The Commission decided that

> [w]hile a single payphone may be installed to handle both coin and coinless traffic, the direct costs of the coin mechanism should be recovered by coin calls. . . . The PSP would not install a coin payphone instead of a coinless payphone unless the additional coin traffic would at least cover the additional costs of a coin mechanism.

Second Report and Order ¶ 52. This reasoning at first has a deceptive logic: the coin mechanism is not employed by the consumer making an access code call, and therefore the coin mechanism is not necessary for that function. But on closer examination, this proposition turns out to be false both theoretically and empirically.

Obviously, when a payphone is used to make a non-coin call, the capital costs of the coin mechanism are not "avoided." The coin mechanism exists, its costs exist, and the costs are incurred whether or not the user deposits a coin.

A moment's reflection reveals that the coin mechanism and coin box are not "avoidable" costs either. As the parties pointed out — and the Commission does not dispute — most payphones would not exist but for the coin mechanism. Id. ¶ 43. This is because, as the Commission recognizes, without the coin mechanism, the average costs per coinless payphone call would go up rather than down. The Commission found that even using AT&T's numbers, and calculating for an average phone, the per-call cost for a coinless phone is \$.38; this is higher than the Commission's estimate for the per-call cost for a marginal coin phone — indeed, higher than the market rate for local coin calls. See id. ¶¶ 45, 108.

Put another way: for consumers who wish to make access code and subscriber 800 calls from payphones, the coin mechanism is not an avoidable cost but a benefit; without the coin mechanism there would be no phone to call from. The coin mechanism clearly provides a benefit to all callers, even those who do not deposit coins. It therefore cannot be considered an avoidable cost. See Hausman Decl. ¶¶ 14-16.

The Commission hypothesizes that, if coin revenue did not cover the additional costs of the coin mechanism and coin box, PSPs would install coinless phones instead. But as the foregoing demonstrates, this is simply wrong. In virtually every case, PSPs would put in no payphone at all if the coin mechanism and coin box costs could not be recovered. If the payphone cannot support a coin payphone (with average costs below $.38 per call) then it could support a coinless payphone (with average costs of at least $.38 per call) only if per-call compensation for coinless calls were set well in excess of the local coin rate.

Again, the Commission's own "marginal payphone" analysis proves this. Under the marginal conditions identified by the Commission, a coinless payphone would operate at a loss. The Commission calculates that the costs of running a coinless payphone for one month is approximately $133.87 to $152.30 per payphone station ($.247 to $.281 per call times 542 calls). See Second Report and Order ¶ 108. But fewer than 200 calls a month are made at an average coinless station; without coin traffic the per-call cost of such calls would be over $.63 per call. See also Report of Arthur Andersen LLP, dated December 1, 1997, at 4 ("Andersen Report") (attached hereto as Exhibit A) (estimating per-call costs for a marginal coinless phone, excluding location rentals, of $.74). It hardly needs to be said that at a per-call compensation rate of $.284, those phones would never be installed in the first place. Thus, the Commission's own calculations establish that coin mechanism and coin box costs are not avoidable, but essential to the provision of payphone service for all users.

One can look at this problem in another way: the purpose of the Commission's approach is to arrive at the price that a private negotiation would achieve in a free and competitive market. IXCs would never be able to negotiate a per-call rate that excluded coin mechanism costs. Suppose an IXC asks a PSP to install a coinless payphone to save the IXC money. The PSP would refuse, saying that it would cost more per call for a coinless payphone because coin calls would not contribute to joint and common costs. And the IXC itself would have no incentive to insist on the installation of a coinless payphone. Indeed, even if the IXC were to take over the site itself, it would install a coin rather than a coinless payphone to lower per-call costs.

The empirical evidence on this point is clear. Andersen's study of Coalition members reveals that of all the Coalition's public payphones, only 1.6% are coinless. See Andersen Report at 3. And the one place where coinless phones are most commonly found is the exception that proves the rule: prisons. Inmates have no coins; inmate facility payphones have no coin mechanisms.[4] As long as the rest of us are permitted to keep change in our pockets, the coin mechanism will remain.

[4]Placement of payphones in inmate institutions may nonetheless be profitable because, almost without exception, only collect calls routed to a presubscribed operator service provider may be placed by inmates. See Comments of Inmate Calling Services Providers Coalition, at 5 (filed July 1, 1996). The PSP can negotiate market-rate compensation on such calls.

In all events, if the Commission were to eliminate the costs of the coin mechanism, a proper avoided cost calculation would also eliminate its benefits. To arrive at a correct result, in other words, the Commission would be required not only to subtract the avoided cost of the coin mechanism but also to subtract the avoided revenue. This methodology would confirm that removing the coin mechanism raises, rather than lowers, the per-call cost of the payphone.

2. *The Commission Grossly Overstates the Cost of the Coin Mechanism*

Even if the coin mechanism is improperly characterized as an avoidable cost, the Commission grossly overestimates these costs. The Commission subtracted the cost of an AT&T 11A coinless payphone from the cost of a coin payphone to arrive at an avoided cost of $650, plus $60 for installation. Second Report and Order ¶ 53. This is wrong for a number of reasons.

First, the AT&T 11A is not an appropriate benchmark for the cost of a coinless phone of otherwise comparable durability and functionality to a typical coin phone. The 11A payphone housing is made of less durable materials than a typical coin phone. This is not merely — or even primarily — because of the need to reinforce a coin phone coin box to prevent theft. Cf. Second Report and Order ¶ 53 n.136. Instead, it is because the 11A is intended for use indoors: of the Coalition's coinless stations that are similar to the 11A (less than one percent of the Coalition's payphones), nearly 93% are located indoors. The phones are simply not designed to stand up to the elements. When costs are corrected to account for this, it emerges that the Commission underestimated the cost of a coinless payphone by over 30%. When the Coalition asked vendors for coinless sets of equal durability and functionality to the standard dumb payphone — but without the coin mechanism — the average quote was $370, not the $200-250 that AT&T represented as the cost for an 11A. See Andersen Report, at 8.

Second, although the Commission used a 10-year average useful life for a coinless telephone, Coalition members report that the useful life for a coinless set similar to the 11A is approximately 7 years. Thus, when compared to the 10-year average coin payphone life cited by the Commission, the average coinless phone lasts only 70% as long. If the price of the 11A — $250 — is adjusted to account for this difference in useful life, the result is $358. See id. at 7.[5]

Third, the Commission overstated the costs of a coin phone by half. The Commission computed the costs of the coin mechanism by subtracting the price of an 11A from the low smart set cost quoted by AT&T. But a study by Andersen of Coalition members indicates that less than one in four coin payphones is a smart set; the balance are dumb coin sets. See id. at 6. The Commission therefore should have subtracted the cost of a comparable coinless phone from the cost of an average coin payphone, that is, a dumb payphone. AT&T's own estimates of dumb payphone prices indicate a low value of $600. See Affidavit of David Robinson at 3, attached to AT&T Comments (filed Aug. 26, 1997).

Thus a realistic evaluation of coin mechanism costs would reflect a difference in price of just over $200, not the $710 figure the Commission used. See Andersen Report, at 8. Even using an unrealistically low cost estimate for the 11A, and ignoring the differences in useful life described above, the added coin mechanism costs amount to $410.

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[5]This difference in useful life also reduces the avoided installation costs for a coinless set. See Andersen Report, at 7.

3. *The Commission Incorrectly Allocated Coin Mechanism Costs Based on Marginal Call Volumes Rather Than Average Call Volumes*

Again assuming that coin mechanism costs can even be considered avoidable costs, it is nonetheless clear that those costs are fixed, not incremental — that is, they do not increase as the number of coin calls increases. For this reason, the per-call avoided coin mechanism costs should be calculated based on an average call volume, not on a marginal call volume. Otherwise, the Commission will in effect be taxing PSPs and location providers and transferring the tax to IXCs. This sort of transfer would be wholly arbitrary.

This point is best illustrated by an example. The Commission found that the capital costs associated with the coin mechanism amount to $12.36 per month. The Commission then allocated those costs to 399 calls (including coin calls plus 411 and 555 calls) made on a marginal payphone to arrive at a result of $.031 per call. In this way, the Commission ensured that the IXCs pay monthly compensation for access code and subscriber 800 calls that does not reflect the cost of the coin mechanism on that marginal payphone. But as a result, the compensation that IXCs pay on an average phone will actually reflect an avoided cost of $15.72 — the $.031 per call adjustment multiplied by the 507 coin and other calls made on an average payphone. Obviously, if the call volume were higher than average, the compensation paid by the IXCs would reflect an even higher "avoided cost."

This problem does not arise with incremental costs — like line savings — because these costs are incurred on a per-call basis, rather than on a fixed basis. The more traffic the phone receives, the higher the costs. If the Commission has properly calculated those per-call incremental costs, the per-call rate will reflect a proper adjustment for the cost differences of coin and coinless calls for each payphone, and no more.

But in the case of fixed costs, the per-call amount must be calculated on the basis of an average payphone to ensure that — on average — IXCs will avoid those fixed costs and no more. If the FCC's method is followed, and the per-call cost of the coin mechanism is calculated based on a marginal phone, the IXCs will be handed a $3.36 windfall — on average — per payphone each month because of the FCC's method of calculation. That money will come out of the pockets of PSPs and location providers; this wealth transfer to the IXCs is wholly arbitrary. See Hausman Decl. ¶ 17.

4. *The Coin Mechanism Cost Adjustment Should Be $.00 Per Call*

The foregoing discussion indicates that the Commission's per-call adjustment for coin mechanism costs — $.031 — is clearly incorrect and wholly arbitrary. Coin mechanism costs are not avoidable, and therefore the adjustment should be $.00 per call. However, if the Commission uses a more realistic figure for avoided coin costs, and properly allocates those costs to average, rather than marginal, call volumes, the result is a corrected adjustment for coin mechanism costs of $.0062 per call. See Andersen Report, at 8.

B. The Commission Overstated Line Savings

The Commission inexplicably biased its estimates for measured line costs upwards. The high estimate for local line charges credited by the Commission was AT&T's estimate of $.029. See Second Report and Order ¶ 55 n.141. The low estimate figure accepted by the Commission was CCI's $.020. See id. Yet the Commission selected $.030 per call for the high estimate — though why the high figure should be yet higher than AT&T's figure is not clear — and $.025 per call for the low estimate — an "average" of the AT&T and CCI data. See id. Nowhere does the FCC explain why the AT&T numbers should be double counted.

This error is compounded by the Commission's treatment of the Coalition data. Like CCI, the Coalition found that measured line costs average to $.020. See Coalition Comments at 16. The Commission stated that it would not credit Coalition data because "[i]n a deregulated environment, LECs will have incentives to select measured service" where it is more efficient to do so. Second Report and Order ¶ 54 n.141 (emphasis added). But LEC PSPs already have incentives to select the most efficient service, as they have been deregulated for six months. The Commission's justification for excluding LEC data — that LEC PSPs are not yet deregulated — was thus clear error.

C. The Commission Improperly Ignored Bad Debt and Collection Costs

The Commission decided that it lacked sufficient information to estimate an amount attributable to bad debt and/or collection costs. Second Report and Order ¶ 56. But common sense and the parties' comments both point to the same conclusion: the number is not zero.

Long distance service is provided not only by AT&T, MCI, and Sprint, but also by a host of resellers, or providers with a mix of resale and facilities-based services, some of whom may quickly flower and fade, like day lilies in August. It stands to reason that as payphones are used to make access code calls carried by such providers, the risk that the per-call charges will not be paid is significant.[6]

[6]The Commission has provided that the facilities-based carrier, not the reseller, is responsible for paying compensation, see Report and Order, 11 FCC Rcd at 20586, ¶ 86; but this does not eliminate this risk. When the LEC hands off a long distance call to a reseller, it identifies the reseller but has no way of knowing the identity of the underlying facilities-based

The experience of independent PSPs confirms that many (mostly small) IXCs do not pay access charges. As ever more small carriers enter the market, the amount of unpaid IXC bills, and the costs associated with collecting them, are likely to rise. This is a real cost the PSPs bear in connection with making their payphones available for access code and subscriber 800 calls. Moreover, regulations place on PSPs as well as IXCs the obligation to establish billing and collection of compensation. It is clear that PSPs will incur costs in connection with that billing, costs uniquely associated with access code and subscriber 800 calls, not coin calls.

APCC filed comments indicating that "at least 8% of billed compensation [for access calls] is not collected," translating into a per-call cost of $.03. See APCC Comments at 14 (filed Aug. 26, 1997). This figure was based on data collected over a period of nearly five years. Id. In addition, APCC found that its members incurred collection costs of $.01 per call; the total of bad debt and collection costs is therefore $.04 per call. Id. Yet the APCC's data is nowhere cited by the Commission; the Commission's failure to explain its decision to ignore this data is error. Moreover, the Commission never explains why it refuses to accept Peoples' data on bad debt costs. Instead, it simply repeats the criticisms contained in parties' comments, none of which undermines Peoples' data.[7]

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carrier. To the extent PSPs will rely on resellers to identify the underlying facilities-based carrier, an unreliable reseller may provide an obstacle to collection of per-call compensation. Implementing a technical solution to this problem may itself entail significant costs for LECs and PSPs that should ultimately be reflected in the amount of per-call compensation.

[7]For example, CWI argues that bad debts and collection costs are also faced by IXCs, see Second Report and Order ¶ 56; to which the answer is: of course they are, and they are passed on to paying customers.

To the extent the Commission relied on the Coalition's failure to submit data on this issue, the Commission acted unfairly. Coalition members have no data on bad debt and